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Will Cordray Recess Appointment Cloud CFPB's Future?

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WASHINGTON - The battle over the Consumer Financial Protection Bureau is moving from Congress to the courts.

When President Obama installed Richard Cordray as director of the CFPB through a recess appointment Wednesday, he set the stage for a legal showdown over the bureau's authority that could take years to resolve. The question isn't if a lawsuit will be filed, but when - and by whom.

Observers expect Senate Republicans and others to challenge the appointment on the grounds that the Senate was not actually in recess. But industry groups may have another argument: that the Dodd-Frank Act does not confer full authority on the bureau without a Senate-confirmed director.

"My reading of Dodd-Frank is that the nonbank authorities don't come into play until you have a director confirmed by the Senate," said Mark Calabria, a former top aide to Sen. Richard Shelby, and the director of financial regulations studies at the Cato Institute. "If I was a payday lender that was sued by this agency, I would counter-sue that they don't have the authority to do it on those grounds, (that) this authority was not in place."

Industry observers said the move casts a shadow of uncertainty over everything the agency does going forward. It's not only bad for banks, but it's bad for the agency and consumers, they argued.

"Even though the consumer advocates I'm sure will cheer this as a terrific move by the president here, I think if they think long and hard about it, they too will be concerned," said Alan Kaplinsky, a partner with Ballard Spahr. "What good is it, no matter what the bureau does, if everything is going to be challenged and tied up in the courts?"

But consumer advocates said Wednesday they were thrilled with the appointment, and were not concerned about the possibility that CFPB's actions would be tainted by legal uncertainty, nor about questions surrounding the validity of a recess-appointed director versus one confirmed by the Senate.

"There is no reason to think that it is illegal to make a recess appointment in three or fewer days," said David Arkush, the director of Public Citizen's Congress Watch division. "I do think that the likelihood of a successful action is so remote that it shouldn't cast any uncertainty over these actions."

Frank Keating, the president and CEO of the American Bankers Association, said the move complicates compliance efforts of banks, and puts the bureau's actions "in constitutional jeopardy."

"Moreover, with this appointment, the President has also altered the composition of the board of [the FDIC](#), potentially undermining its official acts," Keating said. "This is at the same time that [FDIC](#) appointments, including that of its chairman, are pending in Congress."

The legal challenges could come from a number of places, including Capitol Hill, entities regulated by the CFPB or by an industry trade group.

"I think you'll see a whole host of constitutional administrative law arguments," said Don Lampe, a partner with the Dykema law firm. "The question is will you have a lawsuit that interested parties that have standing would bring here very shortly, or would you have individual respondents bringing it up defensively if the CFPB seeks to assert jurisdiction over them."

A lawsuit from Senate Republicans would likely move more quickly than one from the industry, as it would go directly to the federal court for the District of Columbia - known as the "rocket docket" - and would likely be taken up by the Supreme Court.

Republicans on Wednesday called the move an "end-run" around the Senate, which has the authority under the Constitution to offer advice and consent on presidential nominees.

At issue are two separate legal arguments.

No. 1 is whether Obama had the power to make the recess appointment in the first place. No. 2 is whether a recess appointment has the same force of law as a Senate confirmation under Dodd-Frank, which specifically says the CFPB does not have certain powers until "the director of the bureau is confirmed by the Senate."

While a president has the Constitutional authority to fill vacancies when the Senate is in recess, tradition says the chamber has to be in recess for three days for the president to use this authority. House Republicans have conspired with their Senate counterparts to keep that from happening (each chamber needs the other's permission to go on recess) and the Senate has continued to hold "pro forma" sessions in which no business is conducted.

Still, Senate Republican leaders have so far not given any indication that they plan to mount a legal challenge. Indeed, a Senate Republican aide said Wednesday a challenge would more likely come from a private entity, not the Congress.

The White House on Wednesday called the pro forma sessions a "gimmick" designed to prevent Obama from using his Constitutional powers. And some legal scholars don't

think that challenge will hold up in court.

Victor Williams, a clinical professor at the Catholic University Columbus School of Law in Washington, has argued for years that holding pro forma sessions does not prevent the president from making recess appointments, because the Senate is not actually conducting any business.

"It's more than two days break - it's a five week break the Senate has scheduled," Williams said. "At least for the purposes of a recess appointment analysis, it's not a legitimate session. They're not able to render advisory consent."

Challenges from the industry - including a supervised institution or an industry trade group - are likely to take much longer, and depend upon who actually has standing to bring a lawsuit. Institutions will wait to challenge the validity of the recess appointment until the bureau has taken an action that it otherwise would not have been able to take without a director.

"If you're going to sue, you want to make sure that it's absolutely clear that the existence of a director - a confirmed director - is essential," said L. Richard Fischer, a partner with Morrison & Foerster.

Which institution will be the first to challenge the bureau's authority? Calabria said he expects a nonbank will take the first crack, simply because depository institutions almost never want to go to court against their regulator. Nonbanks have less to lose, and are also more likely to be impacted by the bureau's new authority, which includes the ability to oversee nonbanks and the ability to prohibit "abusive" acts or practices.

Many have pointed to the U.S. Chamber of Commerce as the likely plaintiff if a trade group takes up the case. But the group, which includes many of the nonbanks that will be subject to the bureau's authority, would not say whether they are planning legal action.

"I can't tell you who is going to sue," said David Hirschmann, the president and CEO of the Chamber's Center for Capital Markets Competitiveness. "At some point in the future, something the bureau does will lead to a lawsuit. As part of that, you'd almost be committing legal malpractice if you didn't raise the question of whether there was a legal confirmed director, and that puts a dark cloud over everything the bureau does from this day forward that might be invalidated by a future court decision."

Industry players are also likely to challenge the move due to Dodd-Frank's restrictions.

A report from the inspectors general of the Treasury Department and Federal Reserve in January 2010 found that "until a director is confirmed," Section 1066 of the law grants the Treasury secretary the authority to carry out the functions of the bureau that transferred to the bureau from other agencies.

"The secretary is not permitted to perform certain newly-established bureau authorities if

there is no confirmed director by the designated transfer date," the report said.

The report did not specifically address the authorities granted to a recess-appointed director. But the nuance is not lost on Democrats, Republicans or bank lawyers, who are carefully reviewing the language. Republicans are already arguing the language does not give Cordray the authority to regulate nonbanks, while privately many Democrats concede it is a valid issue.

But Cordray made clear Wednesday that the bureau doesn't perceive the language as an obstacle.

He told a group of reporters traveling with the president in Cleveland that he planned to begin exercising its new authority immediately.

"We're going to begin working to expand our program to non-banks, which is an area we haven't been able to touch up until now," he said.

Some industry lawyers said they don't see that argument winning in court. If the appointment is legal, the recess-appointed director would have the same powers as the Senate-confirmed director, said Ray Natter, a partner with Barnett, Sivon & Natter.

"Congress cannot change this result, even if the statute uses the phrase 'Senate-confirmed director,'" Natter said. "That is because under the Constitution the president has the right to make a recess appointment to fill a vacancy, and Congress cannot interfere with that Constitutional prerogative by limiting the authority of an officer that is not Senate confirmed. It would be unconstitutional."

But Wayne Abernathy, a former Treasury official in the Bush administration and now executive vice president for financial institutions policy and regulatory affairs at the American Bankers Association, disagreed.

"I think the courts will assume there's a reason why they did that, and why they said it this way and that they didn't want authority to be exercised by somebody who didn't go through the accountability of the normal appointments process," he said.

In the meantime, the blowback from the decision is likely to affect the entire nomination process, including the advancement of other financial services nominees.

Some observers wondered Wednesday if the president would take the opportunity to push through other nominees, including Marty Gruenberg and Thomas Curry. While the president did install three new members of the National Labor Relations Board through a recess appointment, he was not expected to appoint any others.

Calabria said the Gruenberg and Curry nominations in particular have advanced far enough, he did not think Republicans would hold them up. But he and others said the Cordray appointment has been viewed by Republicans as an act of war, and is likely to

hamper all other presidential appointments, not to mention legislation in 2012.

"There is not going to be any sort of wavering by the Republicans now," Calabria said. "You have essentially said the Senate doesn't matter."

Speculation was rampant that the president would appoint Cordray on Tuesday, during a break between the two sessions of the 112th Congress.

By waiting a day, however, some said the White House has ensured that the appointment will last until the end of the next legislative session at the end of 2013.

The move could have consequences far beyond 2013, however. Cordray has the power to appoint a deputy director who could assume the responsibilities of director once Cordray's appointment expires.

- Kevin Wack contributed to this article.